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IN THE

Supreme Court of the United States

OCTOBER TERM, 1933

No. 62

FIRST NATIONAL BANK OF CINCINNATI and INTERNATIONAL HEATER COMPANY,

Petitioners,

vs.

RUDOLPH B. FLERSHEM, CHARLES O. CORNELL, JOHN H. WATERS, *et al.*, etc.

No. 63

FIRST NATIONAL BANK OF CINCINNATI and INTERNATIONAL HEATER COMPANY,

Petitioners,

vs.

RUDOLPH B. FLERSHEM, CHARLES O. CORNELL, JOHN H. WATERS, *et al.*, etc.

BRIEF FOR PETITIONER FIRST NATIONAL BANK OF CINCINNATI

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INDEX

PAGE

Opinions Below 2

Jurisdiction 3

Concise Statement 3

Specification of Errors—Summary of Argument... 12

Point I. The courts below erred in not carrying out under the Court's supervision a liquidation by separate sales properly designed to bring about the best yield from all the various far-flung properties, reserving in the Court's hands the cash and *Liberty* Bonds and receivables and other virtually liquid assets; and in granting in lieu thereof the desire of a group of the creditors and stockholders that the property be turned over to them as an entirety, without taking such steps and making such investigations as would show beyond peradventure that in so doing the Court did not in effect violate its trust duties or the rights of any of the creditor beneficiaries 14

A. Creditors have the fundamental right to the liquidation of the assets of their debtor so as to provide the greatest possible payment to the creditors. This proposition is basic and self-evident, but this right was completely violated by the decrees below 14

B. The decree of sale was erroneously framed to effectuate the plan of reorganization and not to secure a normal liquidation or its equivalent,—the upset price was grossly inadequate..... 23

PAGE

Point II. The courts below erred in approving the plan in that the plan failed to give full recognition to the rights of creditors while reserving in the stockholders unconditionally an interest in the assets of the corporation; and in that the plan discriminated between general creditors of the same class by providing for the payment of some of them in full in cash while only providing for others securities in the new corporation of comparatively little value 39

A. The creditors' position must be fully preserved before any interest in the new company can be unconditionally given to the stockholders..... 39

B. The plan discriminated between various general creditors of the same class by providing for the payment of some of them in full in cash while only providing for others securities in the new corporation of comparatively little value..... 48

Point III. The District Court erred in parting with the trust fund and directing the delivery of it to the new corporation, there to be consumed and wasted, after the appeal from the final decree of sale had been perfected, as the Court then had become powerless further to act in the premises.... 49

Conclusion. The decrees of the courts below should not be permitted to stand 51

AUTHORITIES CITED

PAGE

Ex-Parte Manhattan Ry. Co., 61 Fed. (2d) 941 (C. C. A. 2d 1932) 21

Graffam v. *Burgess*, 117 U. S. 180, 6 Sup. Ct. 686, 29 L. Ed. 839 (1886) 27

Guaranty Trust Company v. *Chicago, Milwaukee & St. Paul Ry. Co.*, 15 Fed. (2d) 434 (N. D. Ill., 1926) 19, 20, 23, 32, 33

Harkin v. *Brundage*, 276 U. S. 36, 48 Sup. Ct. 268, 72 L. Ed. 457 (1927) 15

Hollins v. *Brierfield Coal & Iron Co.*, 150 U. S. 371, 14 Sup. Ct. 127 (1893) 15

Hovey v. *McDonald*, 109 U. S. 150, 3 Sup. Ct. 136, 27 L. Ed. 888 (1883) 49, 51

Kansas City Southern R. Co. v. *Guardian Trust Co.*, 240 U. S. 166, 36 Sup. Ct. 334, 60 L. Ed. 579 (1916) 41

Kansas City Terminal R. Co. v. *Central Union Trust Co.*, 271 U. S. 445, 70 L. Ed. 1028 (1926) 41

Kingsport Press, Inc. v. *Brief English Systems, Inc.*, 54 Fed. (2d) 497 (C. C. A. 2d 1932) 18

Luhrig Collieries Co. v. *Interstate Coal & Dock Co.*, 281 Fed. 265 (1922) 22

May Hosiery Mills v. *F. W. Grand Stores*, 59 Fed. 2d 218 (1932) 22

Michigan v. *Michigan Trust Company*, 286 U. S. 334, 52 Sup. Ct. 512, 76 L. Ed. 1137 (1932) ... 16

Merrimack River Sav. Bank v. *Clay Centre*, 219 U. S. 527, 31 Sup. Ct. 295, 55 L. Ed. 320 (1910) 49

Municipal Financial Corporation v. *Bankus Corporation*, 45 Fed. 2nd 902 (1930) 24

National Surety Co. v. *Coriell*, 77 L. Ed. 865 (1933) 17, 36, 52

PAGE

Newton v. *Consolidated Gas Co.*, 258 U. S. 165, 42 Sup. Ct. 264, 66 L. Ed. 538 (1921) 49
Northern Pacific Railway v. *Boyd*, 228 U. S. 482, 33 Sup. Ct. 554, 57 L. Ed. 931 (1912) 40, 52
Palmer v. *Bankers Trust Company*, 12 Fed. (2d) 747 (C. C. A. 8th 1926) 19
Pierce v. *U. S.*, 225 U. S. 398, 41 Sup. Ct. 365, 65 L. Ed. 697 (1921) 41
Phipps v. *Chicago, R. I. & P. Ry. Co.*, 284 Fed. 945, 949 (C. C. A. 8th 1922) 19, 43
Pusey & Jones Co. v. *Hanssen*, 261 U. S. 491, 43 Sup. Ct. 454, 67 L. Ed. 763 (1923) 22
Shapiro v. *Wilgus*, 287 U. S. 348, 53 Sup. Ct. 142, 77 L. Ed. 149 (1932) 16, 22, 52
Spencer v. *Taylor Creek Ditch Co.*, 194 Fed. 635 (C. C. A. 9th 1912) 49

STATUTES

Judicial Code, Section 240a 3
Judicial Code, Section 847 24

OTHER AUTHORITIES

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BRIEF FOR PETITIONER FIRST NATIONAL BANK OF CINCINNATI

This case comes before the Court on a writ of *certiorari* to the Circuit of Appeals for the Third Circuit, issued May 29, 1933 (77 L. Ed. 1013).

The decrees below are the decree of the United States Circuit Court of Appeals for the Third Circuit, filed on the 24th day of March, 1933, which affirmed the final decree of sale filed in the United States District Court for the Western District of Pennsylvania on the 31st day of May, 1932, and the decree confirming the sale and approving the plan of reorganization filed therein on the 8th day of September, 1932, in the equity suit

brought in that court entitled *"Rudolph B. Flershem, et al. as the Reorganization Committee,* etc., complainants, against *National Radiator Corporation,* defendant."

Separate petitioners, Artz and Ramsey, (No. 64) did not become intervening parties. They appeared by independent counsel upon the return of the published notice of the application to confirm the sale and approve the plan which ripened into the supplemental decree, dated the 8th day of September, 1932, and attacked the jurisdiction of the Court. A separate suit, through the same counsel as in No. 64, entitled *"Clapier against Flershem, et al."* (No. 65) which was brought as an attack upon the jurisdiction of the District Court also resulted in a separate appeal to the Circuit Court of Appeals. All of these separate appeals were placed on the calendar together by the Clerk of the Circuit Court of Appeals. They were all separately argued at the same time and all disposed of in the one opinion of the Circuit Court of Appeals. Separate petitions for writs of certiorari were made and granted in Nos. 64 and 65 (77 L. Ed. 1013). We understand from the Clerk of this Court that Nos. 64 and 65 are to come on for argument at the same time as the case in which we appear.

Opinions Below

The opinion of the District Court filed upon making the decree of sale is printed at pages 280-3 of the Record. The opinion of the District Court filed upon making the decree confirming the sale is printed at page 463 of the Record. Neither of these opinions is published. The opinion of the Circuit Court of Appeals is printed at pages 534-44 of the Record, and is reported in 64 Fed. (2d) page 847.

Jurisdiction

The jurisdiction arises from the granting of the writ of certiorari herein pursuant to Section 240a of the Judicial Code as Amended by the Act of February 13, 1925.

Concise Statement

This is a suit brought by the Reorganization Committee as complainants in the United States District Court for the Western District of Pennsylvania for the purpose of effectuating a plan of reorganization of National Radiator Corporation (the defendant). The suit resulted in the making of a perfunctory judicial sale in a manner studiously designed to effectuate a transfer of all of the assets of the corporation to the nominee of the Reorganization Committee for the sum of $2,500,000, although in 1927 the same interests as those sponsoring the reorganization represented the corporate assets as having a value of approximately $25,000,000. This representation was made in connection with the sale at that time of $12,000,000, of debentures* (R. 274).

This petitioner First National Bank of Cincinnati is the owner of $68,000 in face amount of such debentures which were acquired by it at the time of their issue at the issue price of $1,000 a debenture (R. 95, 273).

The petitioner International Heater Company is the owner of $60,000 of corporate notes issued to it by the corporation on account of payment of the purchase price for its interest in property acquired from it by the corporation in 1928. That petitioner is submitting a separate brief.

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*Through the operation of the Sinking Fund or by corporate acquisitions the debentures outstanding had been reduced to $10,716,000 at the time of the receivership (R. 36).

The debentures were unsecured. All the creditors were unsecured general creditors.

The suit had its genesis at a directors' meeting of National Radiator Corporation held on the 31st day of January, 1931, at which it was resolved to default upon the debenture interest due February 1, 1931 and to ask the complainants, who include the two ranking officers of the corporation, to act as a Reorganization Committee. It was also resolved that the corporation should undertake to pay the expenses of the Reorganization Committee (R. 499-502). A plan of Reorganization dated February 11, 1931 for the benefit of debenture holders and preferred and common stockholders was immediately promulgated (R. 32).

After obtaining the deposit of $8,736,000 in principal amount of the debentures (R. 9) and a majority of the preferred and common stocks, the Committee filed this suit as complainants on October 5th, 1931 (R. 6). The answer of the complainants to the intervening petition of First National Bank of Cincinnati admits "that they filed the bill of complaint in this cause as a step in effectuating the Plan and Agreement of Reorganization dated February 11, 1931" (R. 99). The bill of complaint prayed "that the properties and assets and business of the defendant may be ordered to be sold as an entirety" (R. 13). The answer of defendant National Radiator Corporation to the bill of complaint "admits the truth of the allegations therein contained, joins in the prayers thereof, and consents to the appointment of a receiver or receivers as therein prayed for" (R. 64). Upon the filing of this bill of complaint and this answer the Court, without legal notice to anyone, on the 9th day of October, 1931, made a decree completely sequestering the assets of the corporation in the Court's hands and appointing Robert S. Waters, the Vice President

and General Manager of the corporation, and William G. Heiner as Receivers and enjoining suits (R. 64-8).

The National Radiator Corporation was organized in August, 1927 to effectuate a merger of six corporations with far-flung plants located in nine states engaged in the business of manufacturing boilers, radiators and similar articles. A public issue of $12,000,000 of unsecured debentures was made in August, 1927 by the respondent Bankers Trust Company as the banking house of issue for the purpose of effectuating this merger. The Bankers Trust Company is also the trustee under the indenture relating to the debentures and also served in the capacity of depositary under the Plan of Reorganization dated February 11, 1931 (Banker's Circular R. 269-80).

The banker's circular in which the corporation joined and upon which the debentures were sold in 1927, showed assets of $26,192,261.72 and liabilities of $1,478,061.72, other than the liability upon the $12,000,000 of debentures and upon shares of preferred and common stock which had a stated liability of $11,500,000 (R. 273-4).

The operations of the corporation for the full years of its operation after the merger became effective and until the receivership, that is to say, the years 1928, 1929 and 1930, showed losses as follows (R. 33):

1928	$1,343,491
1929	1,234,329
1930	1,453,870
	$4,031,690

The business as an entirety was a demonstrated failure.

In February, 1931 at the time the corporation defaulted on the semi-annual interest payment of about $300,000 then due upon the debentures and at which time the Reorganization Committee was organized and the Plan of Reorganization, dated February 11, 1931, was

promulgated, the corporation had current assets of $5,054,007.30 of which $1,701,899.94 was cash. There were then other assets sufficient to bring the total up to $19,434,548.08. The only presently payable liabilities, other than the semi-annual debenture interest then falling due, were $46,787.60 of accounts payable (R. 34-5).

In the spring of 1932 the respondents, without notice to the creditors, submitted to the District Court the final decree of sale which was signed and filed in that Court on May 31, 1932 (R. 283). The three ranking officers of the corporation, Mr. John H. Waters, President (and chief stockholder), Mr. Rudolph B. Flershem, Chairman of the Board, and Mr. Robert S. Waters, Vice President and General Manager (and the President's son), the first two of whom are also members of the Reorganization Committee, were placed upon the stand by the complainants below to testify as to upset price. They wanted to buy the property as cheaply as they could. They testified that about $2,300,000 was an appropriate price (R. 153, 231). The receiver Heiner, who may be said to have been the Court's receiver, was also called by counsel for the Reorganization Committee to testify to the same effect (R. 257). **Both of the receivers as well as the Reorganization Committee, were represented throughout the proceedings by the same counsel** (R. 80).

The decree submitted and signed provided for the sale at New Castle, Pennsylvania, of the property as an entirety, including cash, Liberty bonds, accounts receivable, receivers' inventory, plants and machinery, numerous warehouses, numerous dwellings and an office building and an apartment house. This real estate was situated in nine different states. The decree was studiously designed to effectuate a perfunctory judicial sale for the purpose of accomplishing the Plan rather than a real

liquidation for the purpose of bringing about the best possible yield to the trust in the Court's hands (R. 301, 318-319, 321). These provisions are briefly analyzed at pages 25-8, *infra*.

The Court fixed $2,500,000 as the upset price for such sale (R. 326).

At the time of this hearing the current assets to be the subject of this sale consisted of the following (R. 257-8):

Cash	$ 852,096.29
United States Certificates of Indebtedness	980,000.00
Accrued interest thereon	6,124.97
Bank Certificates of Deposit	50,000.00
Cash surrender of Life Insurance	22,900.00
New York State Bonds	18,686.33
Accounts Receivable	858,992.41
Inventory (merchandise)	1,634,905.25
Total	$4,423,705.25

In addition to this, there were plants and machinery carried in the receivers' inventory after full depreciation at $6,743,419.15 (R. 260). In addition thereto, there were the rights as creditor, majority stockholder and equitable owner of the rest of the stock of the Steel Boiler Company, which we will discuss below. In addition there were the patents; trade-marks and trade-names which with good-will were carried by the corporation at $6,634,501.90 (R. 34) as well as other valuable items.

The Court failed to take suitable measures to assure itself that the sale conducted under such decree and at such an upset price would yield as much as would the holding in the hands of the receivers of the cash, Liberty bonds and receivables and the careful and businesslike sale of the inventory and machinery, plant, equipment and of the very numerous pieces of real estate in separate

lots and the taking of appropriate steps to effectuate a recovery and liquidation of other assets hereafter mentioned. The Court did not secure an appraisal and acted only upon the socalled opinion of the purchasers who wanted to buy the property as cheaply as they could. The proceedings before the District Court relating to this are briefly analyzed at pages 28-39, *infra.*

The petitioner First National Bank of Cincinnati, which at the time of the hearing was making an application to intervene (R. 2), became apprised of the application for the final decree of sale and was permitted to cross examine the above mentioned witnesses. This party besought the Court to take suitable measures in order to investigate the value of the properties and the best method of realizing upon the fund for the protection of this intervenor and of each and every other creditor of the trust fund in the hands of the Court, but this the Court refused to do.

The petitioner International Heater Company was not heard at all upon the application for the decree of sale and learned of the hearing only by chance after it was all over. It thereafter intervened (R. 133) and, together with the petitioner First National Bank of Cincinnati appealed to the Circuit Court of Appeals from the final decree of sale dated May 31, 1932 (R. 332-3). These petitioners also joined in contesting the propriety of making the further order dated the 8th day of September, 1932, approving the Plan and directing the transfer of the assets (the trust fund) from the custody of the Court to the new corporation, and joined in appealing from that decree (R. 477). The latter decree was made after the appeal from the former decree had been perfected.

These petitioners also joined, pending the decision of the appeal from the final decree of sale, in applying

to the Circuit Court of Appeals for a postponement of the transfer by the Receivers of the assets to the new corporation and the approval of the Plan (Supp. R. 552-7). But the presiding Judge of the Circuit Court of Appeals permitted the lower Court to order the transfer of the assets notwithstanding the fact that an appeal from the final decree of sale had been taken and perfected (Supp. R. 564).

The Reorganization Committee (complainants) acted on behalf of debenture holders, preferred stockholders and common stockholders. The Plan provided that the rights of the debenture holders as creditors should as such be cut in half and that their right to receive interest should depend upon earnings. At the same time, the Plan preserved in the preferred stockholders a substantial share in the assets of the corporation in the form of junior securities but without imposing any condition by way of contribution of new capital, or otherwise; in other words, gave them a "free ride." The Plan also provided that the common stockholders, upon the payment of the nominal sum of One dollar in respect to each three shares of old common stock, might acquire a warrant evidencing their right to buy stock of the new corporation at a fixed price at any time within the next ensuing twenty years (R. 40-1). The Plan also provided that the Committee should have the discretion to pay certain ordinary creditors in full in cash (R. 44); and, in carrying out the Plan, all the miscellaneous general creditors (but not including these petitioners or other dissenting debenture holders) were paid in full in cash (R. 434).

As to these petitioners, however, they were permitted to receive only the securities of the new corporation as arranged by the Committee or be relegated to the receipt of such dividend as would follow from this grossly inade-

quate upset price after the deduction therefrom of the amount of such allowances to the complainants and the receivers and the Trustee and their respective counsel as the Court might be induced to grant (R. 309-10). The decree contains a provision reserving out of the cash included in the sale the sum of $300,000 to be used for that and similar purposes (R. 307).

In 1927 the respondents represented the assets to be worth $25,000,000. In 1931 they carried them at $20,000,000. In 1932 they passed them through the Court to their new corporation with a capital structure of $16,000,000 (R. 37, 39-40). But while the assets constituted a trust in the Court's hands, they said they were worth but $2,500,000. The Courts below adopted their views. What is there in the judicial touch which renders assets comparatively valueless when constituting a trust in the Court's hands although of great value at every other moment?

This petitioner brought out upon the cross examination of respondents' witnesses that there had recently been developed in laboratories of the corporation, by officers and employees of the corporation, and at the expense of the corporation, a new type of steel boiler, and that the capital for financing the manufacture and sale of these special boilers was also furnished by the corporation; also, that these patents and devices were put into another corporation called the "National Steel Boiler Company," but that only a bare majority of this stock was issued to defendant corporation, and that the rest of it was issued to some of its officers and employees who claim to own it in their individual rights (R. 200-3). As to this new invention, it was stated in a printed circular addressed by the Reorganization Committee to the debenture holders to induce the deposit of debentures that the corporation "has developed new and improved products of

great promise including, among others, steel boilers" (R. 358-9). This petitioner besought the Court to take appropriate action to have this transaction, which on its face seemed fraudulent, undone, in order that this apparently valuable asset might be recovered for the benefit of the creditors. The Court below, as well as the Circuit Court of Appeals, completely ignored this request and decreed a sale of all the assets as an entirety to the nominee of the Reorganization Committee with the result that the old interests have acquired the rights of the corporation and have thus been put in a position to give themselves immunity for their seemingly fraudulent acts in this important transaction.

The further result of the decrees is to continue the business in the hands of the same management under whose charge it was a demonstrated failure.

In the opinions handed down by the District Court and in the opinion also handed down by the Circuit Court of Appeals, both Courts refrained from discussing the main point urged before each of such Courts by this petitioner, that, the Court having sequestered the whole of the debtor's property for the protection of creditors and enjoined suit, the fund constituted a trust in the hands of the Court, and that each and every creditor had a fundamental right to the due administration by the Court of such trust in such manner as to provide the greatest possible payment to each of the creditors.

Both of the Courts below stressed the fact of the size of the majority of debenture holders represented by the Committee and that testimony had been offered by the Committee which the petitioner did not call witnesses to controvert. Both of these Courts treated the matter as though it were a normal adversary proceeding.

The District Court found that the proceedings were not collusive (R. 281); and the opinion of the Circuit

Court of Appeals approved this finding (R. 537). This petitioner did not claim below and does not claim here that consent sequestration decrees of this nature may not be made or that the existence of collusion is necessarily fatal. But it was perfectly manifest, from its inception and throughout, that the suit was collusively brought and maintained for the mere purpose of effectuating the reorganization plan. As said by the late Judge Mayer, who had perhaps as large an experience as any Judge in the conduct of reorganization receiverships, that, when such proceedings are in fact collusive, it is "much better to be perfectly frank about it." (Lectures on Legal Topics, Vol. 6 (MacMillan Co. 1929), p. 166.)

We believe that we may say with all due respect that the opinions in both the Courts below are not entirely judicial. One of the vices and dangers of the autocratic steps often taken by Courts in the exercise of this rather anomalous jurisdiction is that they are, in rendering their decisions, apt to find themselves in a position of defending their own conduct rather than making the purely judicial determinations which Courts are called upon to render in normal adversary law suits.

Specification of Errors—Summary of Argument

1. The Courts below erred in not carrying out under the Court's supervision a liquidation by separate sales properly designed to bring about the best yield from all the various far flung properties, reserving in the Court's hands the cash and Liberty Bonds and receivables and other virtually liquid assets; and in granting in lieu thereof the desire of a group of the creditors and stockholders that the property be turned over to them as an entirety, without taking such steps and making such investigations as would show beyond peradventure that

in so doing the Court did not in effect violate its trust duties or the rights of any of the creditor beneficiaries.

2. The Courts below erred in approving the plan in that the plan failed to give full recognition to the rights of creditors while reserving in the stockholders unconditionally an interest in the assets of the corporation; and in that the plan discriminated between general creditors of the same class by providing for the payment of some of them in full in cash while only providing for othe s securities in the new corporation of comparatively little value.

3. The District Court erred in parting with the trust fund and directing the delivery of it to the new corporation, there to be consumed and wasted, after the appeal from the final decree of sale had been perfected, as the Court then had become powerless further to act in the premises.

POINT I

The courts below erred in not carrying out under the Court's supervision a liquidation by separate sales properly designed to bring about the best yield from all the various far-flung properties, reserving in the Court's hands the cash and Liberty Bonds and receivables and other virtually liquid assets; and in granting in lieu thereof the desire of a group of the creditors and stockholders that the property be turned over to them as an entirety, without taking such steps and making such investigations as would show beyond peradventure that in so doing the Court did not in effect violate its trust duties or the rights of any of the creditor beneficiaries.

A. Creditors have the fundamental right to the liquidation of the assets of their debtor so as to provide the greatest possible payment to the creditors. This proposition is basic and self-evident, but this right was completely violated by the decrees below.

A bare majority of creditors, or ninety-nine per cent. of the creditors of a mere industrial corporation, have no right to compel a reorganization of the debtor corporation as an entirety by means of an equity receivership unless the dissenting creditors receive substantially what would have been received upon a normal fair liquidation or its equivalent.

The answer of the complainants and defendant to the intervening petition of the appellant herein, states: "The complainants admit that they filed the bill of complaint in this case as a step in effectuating the Plan and Agreement of Reorganization dated February 11, 1931".

(R. 99). There is no such function of a federal equity suit in the event of insolvency, legal or equitable, of a private corporation.

The judicial power of the Federal District Court to sequester the property of the corporation rested upon the facts that the corporation was so embarrassed as not to be able to pay its debts (here rather thinly established and only by the complainants' allegations and the defendant's answer); that the corporate property is a fund for the benefit of all the creditors, and that it was essential to avoid judgments and attachments by various creditors and a waste of the fund in which they are interested. Since the Court has power to take these assets into its hands only as a fund for creditors, it must be so treated. Any other view would be intolerable.

In *Hollins* v. *Brierfield Coal & Iron Company,* 150 U. S. 371, 14 Sup. Ct. 127 (1893), a receivership case, the Court said at page 383:

> "It is * * * a trust in the administration of the assets after possession by a court of equity * * *."

This Court writing by Chief Justice Taft has taken occasion to sound a clear note of warning in *Harkin* v. *Brundage,* 276 U. S. 36, 48 Sup. Ct. 268, 72 L. Ed. 457 (1927). The Chief Justice said at page 55:

> "The desire of those who represent an embarrassed corporation to seek a refuge from active and urgent creditors under the protecting arm of an officer of the court, leads to strenuous efforts to frame a case which may under equity practice justify a receiver. More than this, circumstances which should have no influence lead the parties in interest to prefer one court to another in the selection of the person to be appointed as receiver, with the hope on behalf of those in charge of the embarrassed corporation that the appointment may

> fall to one whose conduct will be in sympathy with, rather than antagonistic to, the previous management of the corporation, in the hands of which the embarrassment has arisen. As the court of appeals says there should be no 'friendly' receiverships, because the receiver is an officer of the court and should be as free from 'friendliness' to a party as should the court itself."

In *Michigan* v. *Michigan Trust Company,* 286 U. S. 334, 52 Sup. Ct. 512, 76 L. Ed. 1137 (1932), this Court took the occasion to renew this warning. The Court said:

> "This court has had occasion to point out the abuses that can arise from friendly receiverships forestalling the normal process of administration in bankruptcy and enabling a tottering business to continue while creditors are held at bay. *Harkin* v. *Brundage,* 276 U. S. 36, 52, 54, 72 L. ed. 457, 464, 465, 48 S. Ct. 268; *cf. Kingsport Press* v. *Brief English Systems* (C. C. A. 2d) 54 F. (2d) 497, 499, 500. Receiverships for conservation have at times a legitimate function, but they are to be watched with jealous eyes lest their function be perverted."

In *Shapiro* v. *Wilgus,* 287 U. S. 348, 53 Sup. Ct. 142, 77 L. Ed. 149 (1932), the Court said:

> "Ordinarily a creditor who seeks the appointment of receivers must reduce his claim to judgment and exhaust his remedy at law. * * * the rule in the Federal courts remains what it has always been. *Pusey & Jones Co.* v. *Hanssen,* 261 U. S. 491, 497; *Scott* v. *Nealy,* 140 U. S. 106; *Hollins* v. *Brierfield Coal & Iron Co.,* 150 U. S. 371, 379; *Matthews* v. *Rodgers,* 284 U. S. 521, 529. True indeed it is that receivers have at times been appointed even by Federal courts at the suit of simple contract creditors if the defendant was

willing to waive the irregularity and to consent to the decree. This is done not infrequently where the defendant is a public service corporation and the unbroken performance of its services is in furtherance of the public good. *Re Metropolitan Railway Receivership,* 208 U. S. 109, 111. It has been done at times, though the public good was not involved, where legitimate private interests might otherwise have suffered harm. *United States* v. *Butterworth Co.,* 269 U. S. 504, 513; *Kingsport Press* v. *Brief English Systems,* 54 F. (2d) 500; *Harkin* v. *Brundage, supra,* p. 52. *We have given warning more than once, however, that the remedy in such circumstances is not to be granted loosely, but is to be watched with jealous eyes. Michigan* v. *Michigan Trust Co.,* 286 U. S. 334, 345; *Harkin* v. *Brundage, supra. Never is such a remedy available when it is a mere weapon of coercion,* * * * " (Italics ours.)

In *National Surety Co., et al.* v. *Valeria E. Coriell, et al.,* 77 L. Ed. 865 (1933), this Court said at page 869, *et seq.:*

" * * * we are of opinion that the decree approving the plan should have been reversed in its entirety because the procedure pursued by the District Court was improper.

First. The non-assenting creditors were entitled to have the plan and their objections considered in an orderly way, and to a decree based on adequate data. The District Court had before it, in support of the plan, only informal, inadequate and conflicting *ex parte* assertions unsupported by testimony. * * * There was no valuation of the assets by a disinterested appraiser; * * * The failure to require relevant data before deciding whether the plan should be approved was not cured by the declaration of the Circuit Court of Appeals that the dissenting creditors were en-

titled to an aliquot share of what, a year later, it might be estimated the property would have brought at a public sale, and authorizing them to recover that amount, if assets available to satisfy their claims were then available.

Second. Every important determination by the court in receivership proceedings calls for an informed, independent judgment. In the case at bar special reasons existed why the court should have secured adequate, trustworthy information. The proceding was not an adversary one; and jurisdiction rested wholly upon the consent of the defendant corporation."

In *Kingsport Press, Inc.* v. *Brief English Systems, Inc.*, 54 Fed. (2d) 497 (C. C. A. 2d 1932) (*certiorari* denied), the Court said at page 501:

"It is vital that such a receivership as this should have the most careful and constant supervision. It should not be the means to continuing an enterprise that does not show evident signs of working out for the benefit of the creditors. Their rights should be preserved at all hazards, and corporate assets applicable to their claims must not be kept at risk in the hope of benefiting stockholders who are in an entirely subordinate position. * * * *The statement of the Supreme Court in Harkin* v. *Brundage, supra, to the effect that receivers should not ordinarily be appointed at the suit of a simple contract creditor should warn any judge, who has found it necessary to appoint a receiver because of special circumstances, to see that the business is liquidated as economically and speedily as possible, unless its continuance is demonstrably beneficial to the corporate creditors."* (Italics ours.)

The complainants, the corporation, the Trustee under the Indenture, the receivers, their counsel and the Courts

below, relied upon the typical railway foreclosure suits such as *Guaranty Trust Company of New York* v. *Chicago, Milwaukee & St. Paul Railway Co.* 15 Fed. (2d) 434 (N. D. Ill., 1926), *Phipps* v. *Chicago, R. I. & P. Ry. Co.*, 284 Fed. 945, 949, (C. C. A. 8th 1922) and *Palmer* v. *Bankers Trust Company*, 12 Fed. (2d) 747 (C. C. A. 8th 1926).

These railway foreclosure suits present situations, both from the legal and the practical point of view, totally unlike the situation presented by the instant case. In the railway foreclosure cases the mortgagee is legally entitled to a decree of foreclosure. The receivers are appointed pursuant to a right of receivership stipulated in the mortgage, and are primarily receivers under the mortgage and for the benefit of the mortgagee. The mortgagee is entitled to buy it in and thus foreclose all other interests.

Furthermore,—and this is very important,—the subject matter is a railway, a public utility, with huge and far-flung properties, all of which broadly speaking are essential to its continued existence and operation. The property is affected by a public interest and the operation of it or of any essential part of it could not be discontinued without consent of public authorities, which consent could not be obtained. Such railway properties are valued at many millions often several hundred millions, and the mortgages under foreclosure are of comparatively huge amounts. In the nature of things such property can only be sold as an entirety, and there is not the least possibility of an outside bidder for it as an entirety. There is but one possible solution, and that is for the property to go to the mortgagee. As the property must thus be taken over in the interests of the mortgagee and its operation continued, a reorganized corporation must be set up for such purposes and new securities

issued to the holders of the bonds under the mortgage. How this corporation can best be set up for the benefit of the bondholders is the real question to be dealt with. A wholly disinterested trustee under the mortgage, and a committee having no interests other than the protection of the bondholders, often do and should represent the bondholders in such a situation. The parties also often take steps designed to give some recognition to the equities of the unsecured creditors. Such plans some times also make provision for the protection of other junior interests, such as preferred and common stockholders, on terms deemed suitable, such as the right to subscribe to stock of the reorganized corporation. But these supplemental measures are in the nature of a concession from the bondholders. In the course of such proceedings it has become a practice for the proposed plan of reorganization to be submitted to the Court, and for the Court to give judicial countenance to the arrangements, although in a sense this is rather an extrajudicial function.

In such cases the Courts have discussed the questions of the right of intervention by bondholders, upset price, the sale of the property as an entirety, etc. Judge Wilkerson in the *Chicago, Milwaukee & St. Paul* case has perhaps gone farther than any other of the judges of this country in giving the aid of the Courts to the accomplishment of a reorganization plan.

We submit that the instant case and the railway foreclosure cases are as far apart as the two poles. Here we have a mere industrial corporation with nothing but general creditors. The corporation is wholly unlike a public utility such as the huge railway companies which are exempt from bankruptcy. The suit, totally unlike a foreclosure suit, is a mere suit by a group of general creditors invoking the power of the Court to sequester

the property of the corporation in order that it may be preserved and liquidated to the best advantage of all the creditors.

In the case of *Ex-parte Manhattan Railway Company*, 61 Fed. 2d 941 (C. C. A. 2d 1932), the Court called attention to the difference between equity receivership proceedings in respect to a public corporation, such as a railway, and in respect to a private industrial corporation, such as National Radiator Corporation. Judge Learned Hand said:

> " * * * if such suits are ever justified, they are justified in the case of a railroad. Bankruptcy not being open, the choice is between this kind of bill, a judgment creditor's bill, either in the District Court or the state court (sec. 70, Gen. Corp'n Laws of N. Y.), or a suit to dissolve the corporation. * * * Dissolution is a heroic remedy for a public corporation. * * * There are no real purchasers for such property as a whole, and it cannot be sold in parcels without destroying it as a public servant. For these reasons interference with the ordinary remedies of creditors is not a grievance, and the only genuine question that can arise is whether the allocation of new interests in the property shall be made in a state or a federal court. * * *"

The opinion below of the Circuit Court of Appeals fails to distinguish between the varying positions of the separate appellants and, speaking of the appellants as a group, falls into error in stating generally that they attacked the jurisdiction of the Court (R. 538).

This petitioner did not question below and does not question here the jurisdiction of the Court,—it is the manner of the exercise of such power which we question. We believe this Court intends to give countenance to the making by the District Courts of general seques-

tration decrees of the assets, even of industrial corporations, upon bills brought by simple contract creditors where the debtor corporation consents, *provided the Court proceeds with a jealous eye to the proper protection of the interests of creditors.* This Court's decisions in *Pusey & Jones Co.* v. *Hanssen,* 261 U. S. 491, 43 Sup. Ct. 454, 67 L. Ed. 763, (1923) and in *Shapiro* v. *Wilgus, supra,* which are cited in the opinion of the Circuit Court of Appeals as authorities in support of the Federal Court's jurisdiction, so indicate. The case of *Luhrig Collieries Co.* v. *Interstate Coal & Dock Co.,* 281 Fed. 265 (1922), from the opinion of Judge Learned Hand in which the Circuit Court of Appeals quotes with approval is to similar effect. But as pointed out in the opinion in that case on page 269:

> "Such bills may, of course, be abused by the collusion of the debtor and friendly creditors. They may be abused by the court's refusal to allow a present liquidation, disregarding the creditors' unqualified right to present payment, and preserving the property for the debtor, which is not entitled to more consideration than its creditors collectively think wise to give it. But that has nothing to do with the propriety of the bills as such; they form a necessary and important part of insolvency law, and are of unquestioned validity."

We do not share or urge the extreme views of the United States District Judge in Montana who recently committed for contempt the attorneys who appeared before the Court to submit the usual complaint, answer of the defendant corporation and consent to the sequestration decree. (*May Hosiery Mills* v. *F. W. Grand Stores,* 59 Fed. 2d 218 (1932))

But it is presently a matter of public comment that the Federal Courts have been guilty of abuses in their

method of conducting such proceedings.* Such criticism is not without justification. We submit that the instant case is an example of such abuse.

The Court in cases such as the instant one may be properly characterized,—to coin a phrase,—as "a judicial trustee." It is the plain duty of the Court, having exercised its great judicial power in taking into its hands the properties of this corporation for the purpose of handling it for the protection and benefit of all the creditors, to do just that thing. The receivers as officers of the Court must proceed solely in accordance with that single, plain principle. That this was not done here is self-evident.

B. The decree of sale was erroneously framed to effectuate the plan of reorganization and not to secure a normal liquidation or its equivalent,—the upset price was grossly inadequate.

As pointed out above, ninety odd per cent. of the debenture holders and a majority of the stockholders leagued together under the sponsorship of the management and the Trustee under the Indenture for the purpose of becoming the owners of all the corporate property. Their interest obviously was to buy the property as cheaply as possible. The interest of the other creditors was to have the property sold by normal liquidation or its fair equivalent at the highest possible price. The right to a fair liquidation or its equivalent could not be destroyed by the banding together of a majority of the creditors to secure the property for themselves for the

*Lowenthal (1933), *The Investor Pays* (this is a thorough commentary upon the Chicago, Milwaukee & St. Paul receivership—*Guaranty Trust Co. v. Chicago, Milwaukee & St. Paul Ry. Co., supra* p. 19—with references to the Congressional investigation, records, etc.); Wham, *Consent Receiverships in the Federal Court*, Amer. Bar. Assn. J., Jan. 1933, page 7; Finletter, *Federal Consent Receiverships*, 15 Penn. Bar. Assn. Quarterly, March 1933, page 1; Powers, *Friendly Receiverships in the Federal Courts* (1933) 17 Ill. L. Rev. 542; N. Y. Times, April 10, 1933, page 27; *The Fee Feed-Bag*, American Mercury, June 1932, pp. 140-9.

lowest possible price. *The majority of the beneficiaries of a trust have no power to induce a breach of it for their own benefit.*

The complainants (Reorganization Committee), the management, and the receivers gave opinion testimony before the District Court as to upset price which was inconsistent with the established facts and, indeed, ridiculous. The Trustee under the Indenture acquiesced. Current assets alone were approximately $4,500,000. In addition to this, there were the plants, warehouses, dwellings, office building, machinery, patents, trademarks, trade-names and all other assets carried at about three times the amount of the current assets. For all of these assets the complainants and the trustee sought an upset price of about $2,300,000, and the District Court virtually acquiesced by fixing an upset price of $2,500,000.

If the concern were as worthless as the Court found it to be, the proceedings should have been dismissed so that the matter could be taken to the bankruptcy side of the Court where liquidation is the watchword. (*Municipal Financial Corporation* v. *Bankus Corporation,* 45 Fed. 2nd 902 (1930).)

In addition to fixing such an upset price, the District Court decreed that all of the assets and properties of the corporation should be sold at public auction *at Newcastle, Pennsylvania,* for $2,500,000. It need hardly be pointed out that the sale of parcels of real estate located in Chicago, Illinois, Richmond, Virginia or Framingham, Massachusetts, for example, should not be conducted at the County Court House in Newcastle, Pennsylvania. Furthermore this was in violation of Section 847, Title 28 of the Judicial Code.

If the Court contemplated taking the measures best designed to protect the interests of the creditors, the

underlying principle of a proper decree of sale would be this: *the decree of sale should have been shaped so as best to effectuate an advantageous sale of every asset of the corporation.* Translated into practical effect, this means that the decree of sale should not have provided for the sale of cash, receivers' accounts receivable, government bonds and life insurance, either separately or in a lump sum, and certainly not together with miscellaneous pieces of real estate. They were liquid assets in the Receivers' hands. The merchandise inventory should have been sold in the wholesale market for which it was intended; every separate piece of real estate should have been sold separately, not at Newcastle, Pennsylvania, but at the places where the properties were respectively located; the Court should have decreed a separate investigation and sale of the majority stock, and the equitable claim to the rest of the stock of the National Steel Boiler Company.

The decree, we admit, might properly have provided for the sale of all of the assets and properties as an entirety for the purpose of effectuating the plan, *but only if the Court could assure itself beyond peradventure by way of an upset price, fixed upon a thorough and independent investigation, that the net result to the creditors would be at least equal to that obtainable as a result of fair and normal liquidaion.*

The manner of conducting the sale

The decree of sale contained elaborate formal findings and recitals and proceeded to fix the upset price for each of the separate parcels to be offered for sale and for all of the assets and properties as an entirety, as follows (R. 305):

"Parcel	A	$2,392,000
"	B	28,000
"	C	17,500
"	D	37,500
"	E	17,500
"	F	1,000
"	G	2,250
"	H	1,000
"	I	1,000
"	J	2,250
and Parcel K which is the total		$2,500,000"

The decree shows that: Parcel A comprised all the property situated at Johnstown and New Castle consisting of two plants at Johnstown, one at New Castle, an office building and numerous dwellings plus all the cash, Government bonds, receivables, inventory, cash surrender value of insurance policies, interests in Steel Boiler Company, patents, trade-marks, going business and every asset of every description other than the real estate and plant situated at places other than Johnstown and New Castle. Incorporated in the figure of $2,392,000 for Parcel A are items of cash, United States certificates, certificates of deposit, insurance policies, Receivers' accounts and notes receivable, and Receivers' inventory, aggregating approximately $4,500,000 (R. 321). The cash, United States certificates and other similar cash equivalent items amounted to $1,929,807.59.

It should also be noted that this item "A" virtually represents what was put into the National Radiator Corporation in 1927 by the old National Radiator Company plus what was put into it at that time by the Union Radiator Company which also had a plant at Johnstown, and that the security holders of the old National Radiator Company received at the time of the merger cash,

debentures and other securities issued to them by the defendant corporation for their properties amounting to more than $13,000,000 (R. 254).

Let us examine another parcel, for example their Parcel E. This consists of three pieces of real estate located at Chicago, the plant, the warehouse and the Edgewater Apartment Hotel, to all three of which the Court allocated an upset price of $17,500. The Chicago plant and the warehouse are carried together on the Receivers' inventory at $605,149.43 (R. 169). *All of these three parcels of Chicago real estate were decreed to be sold in one lot at a sale to be conducted at New Castle, Pennsylvania, for an upset price of $17,500.*

Parcels F, G, H, I and J, for three of which the upset prices were $1,000 each and for the other two $2,250 each, covered warehouses situated in several States in which there were no plants. These warehouses were included in the inventory at values of from about $30,000 to about $50,000 each.

Similar absurdities apply throughout.

The decree contained various provisions such as those relating to deposits by bidders, etc., which made it difficult for outsiders to become bidders although easy for the Committee to become so (R. 300-9).

True it is that the corporate assets were sold at judicial sale. But frankness would compel all to admit that the sale was wholly perfunctory and technical. No one could say that the making of this technical judicial sale in the manner in which it was conducted was any evidence of a genuine effort by the receivers or the Court to bring about a liquidation advantageous to the estate.

In the case of *Graffam* v. *Burgess*, 117 U. S. 180, 6 Sup. Ct. 686, 29 L. Ed. 839 (1886), the Court undid a judicial sale and said at page 186:

"It is insisted that the proceedings were all conducted according to the forms of law. Very likely. Some of the most atrocious frauds are committed in that way. Indeed, the greater the fraud intended, the more particular the parties to it often are to proceed according to the strictest forms of law."

The Determination of the Upset Price

Let us examine more closely what the Court did in arriving at the upset price. The Court had made no appraisals of the various plants, warehouses, dwellings, office building, apartment hotel, machinery, patents and other miscellaneous properties of the corporation. The Receivers made no appraisals or other examination (R. 261).

There was no real evidence before the Court as to the value of the property, other than the important evidence of the original Bankers' Circular and the Receiver's inventory.

As of December 31, 1931 (the nearest date for which figures were available), the receivership had the following current assets (R. 257-8):

Cash	$852,096.29
United States Certificates of Indebtedness	980,000.00
Accrued interest thereon	6,124.97
Bank Certificates of Deposit	50,000.00
Cash surrender of Life Insurance	22,900.00
New York State Bonds	18,686.33
Accounts Receivable	858,992.41
Inventory (merchandise)	1,634,905.25
Total	$4,423,705.25

In addition to this, there were plants, warehouses, dwellings and office building carried in the Receivers' inven-

tory at $6,743,419.15 (R. 260). In addition thereto, there were the rights as creditor, majority stockholder and equitable owner of the rest of the stock of the Steel Boiler Company. In additon there were the patents, trade-marks and trade-names which with good-will were carried by the corporation at $6,634,501.90 as well as other items (R. 34).

The counsel, who appeared for the Reorganization Committee as well as for the Receivers, called to the stand Messrs. Robert S. Waters and Flershem (one the son of the chief proprietor of the business and the other a ranking officer and member of the Reorganization Committee) and Heiner (one of the Receivers) and, over the objection of this petitioner, asked them to tell the Court what they thought the upset price should be. Waters said $2,195,695 (R. 154). Flershem said $2,300,000 (R. 230). Heiner said $2,229,073.98 (R. 257). There was some variation (apparently a studied one) in the explanations offered in arriving at these virtually similar results. Their testimony may be summarized by the following table:

	Receivers' Books	Waters (R. 153-5)	Flershem (R. 230-1)	Heiner (R. 257-8)
Cash, Liberty Bonds, etc.	$1,929,807.59	1,929,807.59	1,929,807.59	1,929,807.59
Accounts Receivable	858,992.41	172,000.00	425,000.00	214,498.10
Inventory (merchandise)	1,634,905.25	327,000.00	480,000.00	163,490.52
Plants	6,743,419.15	500,000.00	0.00	500,000.00
All other assets (corporation books)	6,634,501.90	0.00	0.00	0.00
		2,928,807.59	2,834,807.59	2,807,796.21
Deduct cost of liquidating receivables and merchandise		635,000.00	750,000.00	578,722.23
		2,293,807.59	2,084,807.59	2,229,073.98

*Except for Heiner's, the final totals were wrong. That arose simply from the bad arithmetic of the other two.

This meant that the accounts receivable and the inventory (merchandise) in the hands of the Receivers were not assets at all but a large liability.

It may be noted in passing that at a meeting of the Reorganization Committee held on the 28th of November, 1931 (the minutes of this meeting are printed at R. 516-520), they considered "what would be the proper amount of the upset price in the event an upset price were insisted upon by the Court" (R. 518), and hit upon the figure of $3,600,000, inclusive of $1,400,000 cash (R. 519), the equivalent, of course, of $4,129,807.59 inclusive of $1,929,807.59 of cash. Mr. Flershem attended that meeting and approved the minutes (R. 520). Consistency required him to suggest to the Court the figure $4,129,807.59 instead of $2,300,000 and clearly he stultified himself.

It should here be pointed out that, as appeared by the testimony of Mr. Robert S. Waters, more had been collected on the accounts and notes receivable of the corporation between October 8, 1931 (the date of the receivership) and December 31, 1931 than such receivables were inventoried at as of the date of the receivership,—that is to say that the reserve for collectibility was so large and that they had collected so many of the accounts in full that the amount which they had collected exceeded the amount of the receivables after deducting the reserve (R. 214). It also appeared that the amount of the receiver's accounts receivable reflected a similar reserve. This was a 12% reserve. The testimony of the same witness also shows that by December 31 the bulk of the corporation's inventory (merchandise) which appeared at cost upon the inventory filed by the Receivers as of October 8, 1931, had been sold by the Receivers at cost plus 15% to 20% (R. 193-8). It follows, therefore, that the accounts receivable and the inventory which the Re-

ceivers had on hand at the time of the sale practically consisted of accounts receivable created by the Receivers and of goods manufactured by the Receivers.

The Receivers have therefore stated that they used the funds of this receivership to manufacture goods which they said cannot be sold for more than 10% of their cost and that they have sold merchandise manufactured by the Receivers to purchasers from whom they do not believe they can collect 25¢ on a dollar. They then said that it would cost them $600,000 or $700,000 to collect 25% of the receivables and 10% of the inventory. This was an amazing account of their stewardship for the Receivers to make to the Court which appointed them. But the Court accepted it and acted upon it.

The inventory figures filed by the Receivers show $6,743,419.15 for plants (R. 260). This figure is arrived at on the basis of the expert appraisal made in 1927 for the purpose of the issuance of these debentures, after giving effect to a depreciation of such appraisal values of buildings aggregating about 12½%, of some of the equipment aggregating about 40% and of some other of the equipment aggregating about 75% (R. 164).

The appraisal of these plants seems to have fairly reflected actual value for one of them was sold after the merger at substantially more than its appraised figure, *viz.*, the Utica plant sold for $733,000 (R. 167). The $6,743,419.15 represented the remaining plants at their appraised value, after giving effect to the cost of additional investments in plants, less the above stated depreciation.

This interest in the Steel Boiler Company which goes along with the rest is apparently of importance. As above stated, the Reorganization Committee so treated it, for in their printed circular to induce the deposit of debentures they referred to it as a valuable new depar-

ture in such a way as to induce the debenture holders to hope that because of it the huge deficits might be converted into profits. But the Court did nothing to ascertain its true value or to undo the apparently fraudulent transaction in turning over nearly half the ownership of it to a few corporate officers.

An examination of the evidence submitted by the complainants upon the question of upset price shows that it was designed apparently to comply with what they seem to regard as a judicial standard enunciated by Judge Wilkerson's ruling in the Chicago, Milwaukee & St. Paul mortgage foreclosure suit, *viz.*, that the upset price should be fixed at a minimum so low that it would shock the conscience of the Court to confirm a sale at a lower price. Reference to the opinion of Judge Wilkerson to that effect was read into the question propounded to their first and star witness Robert S. Waters (R. 151).

The following appears in the cross examination of this witness:

> "Q. We will have to put it this way: That you are stating the price below which a court should not confirm the sale? A. Yes, that is right.
>
> Q. And should not, because it would be such a low price that even you, substituting yourself for the court, would say that you would be shocked at anything below that being acceptable to a court because of its gross inadequacy. Is that right? A. That is right" (R. 220).

That was the basis of their chief witness' testimony as to value. Their other witnesses who merely testified to the same effect, added nothing. The Court accepted the figure thus suggested without making any investigation.

As shown above the very doubtful principles adopted by Judge Wilkerson for the purpose of determining upset price in the Chicago, Milwaukee & St. Paul foreclosure do not in the least govern the proper determination of that question as applicable to the instant case. The assets in the instant receivership were susceptible of normal liquidation. The testimony offered therefore to justify the acquisition of the property of this corporation for a grossly inadequate consideration is wholly inapplicable and worthless. But it should be noted that for the properties sold under Judge Wilkerson's foreclosure decree that Judge fixed an upset price aggregating $122,000,000,—no paltry sum.

Since the Court below could not rely upon the disinterested assistance of its Receivers in advising and assisting the Court for this purpose, obviously the Court should have taken the official figures which were before it or appointed independent and competent appraisers to appraise the properties. But as above stated, the Court made no independent investigation of values and instead went into the realm of pure speculation and arbitrarily fixed upon the figure $2,500,000 which was but 10% of the valuation placed upon the assets in 1927 when the same interests who have now acquired the property sold us the debentures.

Upon the state of the record the assets should have been taken as follows for the purpose of establishing the upset price:

The current assets of a readily liquidable value of $4,423,705.25 should have been taken at that figure.

The plants, warehouses, dwellings and office building which are set out in the Receivers' inventory at $6,743,-419.15 (R. 260) should have been taken at that figure.

As to the assets, such as the Steel Boiler Company, patents, trade-marks, trade-names, etc., these no doubt

have substantial values. We have already commented upon the Steel Boiler transaction. Until very recent years the corporation conducted an advertising campaign on the basis of over $100,000 a year. It has a broad distribution of its products and its trade-names are well and favorably known (R. 239). As to the patents there is but little before us, but it is fair to presume that as the testimony shows that the corporation maintained an experimental laboratory (R. 202), patents and exclusive processes may have been evolved having very considerable value. It may be noted that the receivers obtained an order permitting the retaining of patent counsel (R. 3). The only figure that there is as to such assets is the $6,000,000 odd at which these assets were carried upon the balance sheet of the corporation. The Receivers' inventory omits to mention these assets. But the question of the value of these assets becomes academic if the Court had proceeded in the manner above set out in respect of the other assets. For then the aggregate value would be greater than the indebtedness and beyond that point the interest of the creditors ceases.

Nor would the winding-up of the receivership upon the basis of the payment to the dissenting creditors in full be other than it should be. Even after the operating loss of $5,000,000 of their $25,000,000 of assets with which they started in 1927, there should still be $20,000,000 left. We are but using the figures upon which they sold us the debentures. The protagonists of the Reorganization Plan seem to believe that this $20,000,000 of property can be operated by them at a profit. If so, there is certainly nothing excessive in the idea of their paying $11,000,000 for it,—even upon a judicial sale.

We submit further that the Plan of Reorganization itself ridicules the upset price of $2,500,000 fixed by the

District Court. The Plan calls for a new capital structure approximately as follows:

	Authorized	To Be Presently Outstanding
5% Debentures	$5,500,000.	$5,358,000.
$7 Preferred Stock (without par value)	55,000 shares	53,580 shares
Common Stock	400,000 shares	272,966 shares

If the assets were worth but $2,500,000 the new corporation would be hopelessly insolvent at its start. The 53,580 shares of preferred stock issued to former debenture holders would be worthless rather than having the liquidating value of $115 a share ascribed to them by the plan. The 400,000 shares of common stock would of course also be worthless.

The Court erroneously permitted the respondents to prove over the objection of this petitioner the quoted market of the debentures (R. 135-6). Apparently this affected the Court's mind in arriving at the upset price. It is significant that the upset price arbitrarily fixed by the Court was such as to make a yield to dissenting debentures of about their quoted market price.

Whatever the investment public's opinion of the fair liquidating value of a property in receivership may be, the public is loath to bid for securities of corporations in receivership. There are no quotations, therefore, excepting those that reflect the market which the management and bankers in control of the situation may see fit to create.

Furthermore, even in cases of corporations not in receivership, it is well known that during this depression their shares of stock have been selling in the public

markets at much less than the liquidating value of their assets.*

It is also a matter of common knowledge that the shares of stock of numerous investment trusts have at times during the depression been selling for substantially less than the aggregate market value of their portfolios of securities.

All this goes to show how irrelevant and misleading such testimony is and again demonstrates the error of the Court in disposing of this question.

The error of the District Court goes deeper than the Court's failure to obtain disinterested appraisals and conduct other appropriate investigations, such as the opinion of this Court in the case of *National Surety Company* v. *Coriell, supra,* clearly shows were requisite. We must say, with all due respect, that the District Court in its determination of the upset price was palpably autocratic and unfair. In the name of fairness, it was clear that the current assets alone, consisting of cash or cash equivalent $1,929,807.59, Receivers' receivables after the allowance of 12% reserve for collection $858,992.41, and Receivers' merchandise at cost $1,634,905.25, but saleable in the regular course of business at prices 15% or 20% above cost, should have been taken at something substantially the equivalent of the amount at which they were thus carried upon the Receivers' books, *viz.* $4,423,705.25; and that the seven

*In an illuminating article by Benjamin Graham entitled "Inflated Treasuries and Deflated Stockholders", appearing in the June 1, 1932 issue of Forbes Magazine at page 11, the following appears:

> "A study made at the Columbia University School of Business under the writer's direction, covering some 600 industrial companies listed on the New York Stock Exchange, disclosed that over 200 of them—or fully one out of three—have been selling at less than their net quick assets. Over 50 of them have sold for less than their cash and marketable securities alone."

This article and two others by the same author in the June 15 and July 1, 1932 issues of the same magazine are supported by tables setting out the facts in connection with many named corporations.

large and important plants with their equipment, the six separate warehouses, the numerous dwellings and the Johnstown office building appearing upon the Receivers' inventory after very large depreciations at a valuation of $6,743,419.15, should have been put into the calculation at, at least, some decent figure, even if only a third or so of the $6,743,419.15; and that some substantial figure, even though a comparatively modest one, should have been ascribed to the other numerous miscellaneous assets, such as the interest in the Steel Boiler Company, the apartment hotel at Chicago, the patented processes and devices; with the result that an upset price of not less than three times that fixed by the Court would have been fixed. By such rule of thumb method, a rough estimate might have been reached which could be stated with some show of reason to have been fairly in accord with the result that complete appraisals and investigation might have produced. Although a determination arrived at in that manner would still have been most irregular and have constituted a speculative and dubious remedy, it would at least have evidenced an attempt to give the creditor beneficiaries of the trust substantial justice.

The opinions of both the Courts below show clearly that these Courts were laboring under a fundamental error in that they determined the matter as though it were the trial of issues in an ordinary lawsuit between this petitioner on the one side and the complainants, the corporation and the Trustee on the other. The Courts below put much reliance upon the fact that the Reorganization Committee offered themselves as witnesses to give their opinion as to the appropriate upset price at which they should be permitted to buy the property, and that, as these petitioners did not offer witnesses to testify otherwise, the matter must be disposed of as though an issue were presented for adjudication upon

uncontroverted testimony. *This means that this creditor, who is a beneficiary of the trust fund and who was beseeching the Court to perform its trust duty to it and to the other creditors, must, at its own expense, call experts to come forward with appraisals of elaborate plants and plant equipment located in nine different states, as well as experts with opinions upon the value of other property. The expense of such an undertaking might well approximate the face value of the claim of this objecting creditor, even though its claim is of a comparatively large amount. No holder of relatively few debentures could afford to undertake the burden and expense of thus protecting the trust fund in the interest of all the other debenture holders. In any case it is not their duty but the duty of the Court, the judicial trustee.*

The decree indicates that the Court has in mind the use of the fund to the extent of as much as $300,000 for administration allowances (R. 307). The decree shows that the Court has in contemplation the making of these allowances to the Reorganization Committee, the Receivers, the Trustee, and their respective counsel (R. 309), all of whom were seeking, not to defend the trust, but to defeat it by having the Court turn over the trust fund to their nominee at as low a price as they could induce the Court to fix. The Courts have proceeded thus far in the case upon the basis that several hundred thousands of dollars of the fund may be made available for allowances, etc., for those who stand in the position of seeking to defeat the trust and the rights of the trust beneficiaries, while any of the trust beneficiaries who seek from the Court a true administration of the trust are told that, if the trust is to be protected, this must be done at their individual expense.

It is submitted that the upset price fixed by the District Court at $2,500,000 was grossly inadequate

and the procedure of the Court in arriving at it improper, and that the final decree of sale was erroneously framed merely to effectuate the reorganization plan and without proper provision for a fair and normal liquidation or its equivalent.

POINT II

The courts below erred in approving the plan in that the plan failed to give full recognition to the rights of creditors while reserving in the stockholders unconditionally an interest in the assets of the corporation; and in that the plan discriminated between general creditors of the same class by providing for the payment of some of them in full in cash while only providing for others securities in the new corporation of comparatively little value.

A. The creditors' position must be fully preserved before any interest in the new company can be unconditionally given to the stockholders.

The Plan and Agreement of Reorganization, being for the benefit of stockholders as well as creditors, provides (R. 36):

> "To this end, the management (which includes the owners and representatives of owners of substantial amounts of the Debentures and the Preferred and Common Stocks) has requested the undersigned, Rudolph B. Flershem, Charles O. Cornell and John H. Waters to act as a Reorganization Committee to formulate and submit to the security holders a Plan of Reorganization designed to accomplish the objects recommended by the management."

On page 7 of the printed Plan (R. 41) will be found the following:

> "2. Holders of 7% Cumulative Convertible Preferred Stock of the Corporation will be entitled to receive for each share of deposited stock one share of New Common Stock."

An interest was also preserved for holders of common stock.

In *Northern Pacific Railway Company* v. *Boyd*, 228 U. S. 482, 33 Sup. Ct. 554, 57 L. Ed. 931 (1912), the Court said at page 504:

> "For, if purposely or unintentionally a single creditor was not paid, or provided for in the reorganization, he could assert his superior rights against the subordinate interests of the old stockholders in the property transferred to the new company. *They were in the position of insolvent debtors who could not reserve an interest as against creditors.* Their original contribution to the capital stock was subject to the payment of debts. The property was a trust fund charged primarily with the payment of corporate liabilities. Any device, whether by private contract or judicial sale under consent decree, whereby stockholders were preferred before the creditor, was invalid. Being bound for the debts, the purchase of their property, by their new company, for their benefit, put the stockholders in the position of a mortgagor buying at his own sale. If they did so in good faith and in ignorance of Boyd's claim, they were none the less bound to recognize his superior right in the property, when, years later, his contingent claim was liquidated and established. That such a sale would be void, even in the absence of fraud in decree, appears from the reasoning in *Louisville Trust Co.* v. *Louisville, N. A. & C. R. Co.*, 174 U. S. 683 * * *." (Italics ours.)

We submit that under the authority of this case, the Court may not frame a decree designed for the purpose of conveying this property to the Reorganization Committee or their nominee as a mere "step in effectuating the Plan and Agreement of Reorganization," which makes unconditional provision for stockholders while reducing the position of general creditors as such by one half. The appellant First National Bank of Cincinnati is a general creditor with the same rank and position as every other general creditor. In this corporation there is none but general creditors, the bulk of whom are debenture holders who have deposited their debentures with the Reorganization Committee, the rest of whom are debenture holders who have not deposited, and miscellaneous general creditors.

We are not overlooking what the Court said in the *Boyd* case at page 508, *viz.*:

> "This conclusion does not, as claimed, require the impossible, and make it necessary to pay an unsecured creditor in cash as a condition of stockholders retaining an interest in the reorganized company. His interest can be preserved by the issuance, on equitable terms of income bonds or preferred stock. If he declines a fair offer, he is left to protect himself as any other creditor of a judgment debtor; and, having refused to come into a just reorganization, could not thereafter be heard in a court of equity to attack it."

Nor are we overlooking the decisions which have since been made in the railway foreclosure cases applying this qualification. See *Kansas City Southern R. Co.* v. *Guardian Trust Co.*, 240 U. S. 166, 36 Sup. Ct. 334, 60 L. Ed. 579 (1916); *Pierce* v. *U. S.*, 255 U. S. 398, 41 Sup. Ct. 365, 65 L. Ed. 697 (1921).

In *Kansas City Terminal R. Co.* v. *Central Union Trust Co.*, 271 U. S. 445, 70 L. Ed. 1028 (1926), the

Court referred to the *Louisville* case (which is the decision underlying the whole doctrine) and after quoting from it as follows at page 454, stated that *this doctrine is "fixed principle * * * and to it there should be rigid adherence."*

> "But 'no such proceedings can be rightfully carried to consummation which recognize and preserve any interest in the stockholders without also recognizing and preserving the interests, not merely of the mortgagee, but of every creditor of the corporation. In other words, if the bondholder wishes to foreclose and exclude inferior lien-holders or general unsecured creditors and stockholders, he may do so, but a foreclosure which attempts to preserve any interest or right of the mortgagor in the property after the sale must necessarily secure and preserve the prior rights of general creditors thereof. This is based upon the familiar rule that the stockholder's interest in the property is subordinate to the rights of creditors; first of secured and then of unsecured creditors. And any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation.' *Louisville Trust Co.* v. *Louisville N. A. & C. R. Co.*, pp. 683, 684 (43 L. ed. 1134, 19 Sup. Ct. Rep. 827)."

But the solution permitted to be adopted in the railway mortgage foreclosure cases is worked out upon a set of legal and equitable rights entirely different from the legal and equitable rights involved in the instant case.

In the railway foreclosure cases, the legal right of the mortgagee to a foreclosure and sale overshadows the rights of the general creditors and stockholders.

Although as a strict legal right, the mortgagee is entitled to the foreclosure, the Court of Equity, whose jurisdiction the mortgagee invokes for this purpose, may see fit not to permit the ruthless assertion of this right. The Court will not overlook the fact that the property must be sold as an entirety and that the mortgagee is the only possible purchaser and that, therefore, the mortgagor has not the least possibility of protecting its equity. The Court of Equity has the power upon general principles to refuse its aid except upon proper conditions recognizing the other equities,—the equities of the general creditors and the stockholders. The terms which the Court of Equity imposes as a condition to the exercise of its equitable power become formulated in a plan of reorganization giving primary recognition to the bondholders with suitable recognition to the general creditors and stockholders. It is thus that in the railway foreclosure cases there is a clearer power in the Court of Equity judicially to deal with and approve a plan of reorganization and to decree a technical judicial sale as a step in effectuating it.

The case of *Phipps* v. *Chicago, R. I. & P. R. R. Co., supra,* which is cited in the opinion of the Circuit Court of Appeals and upon which the respondents chiefly rely, does not give the least countenance to a plan of reorganization, such as the one approved by the Court below. There are three vital distinctions. The first is that the stockholders were *not* given a "free ride", but were subjected to substantial presently payable cash assessments as a condition to obtaining stock in the reorganized corporation. The second vital distinction is that the *Phipps* case does not, as claimed by the respondents below, deal with a situation involving only general creditors. The case had to do with the reorganization of a trunk line railway which had a very large mortgage indebtedness.

The procedure in that reorganization was rather unusual as it was not carried out under a foreclosure of the mortgages, and the bonds were not disturbed by the reorganization. The property was taken over by the new corporation subject to the bonds. Securities junior to the bonds were given to the general creditors and the stockholders were permitted to subscribe additional capital for securities junior to the securities issued to the creditors. The third vital distinction is that the subject matter of that suit was a railway.

We do not believe there is an authoritative judicial decision, whether in railway foreclosure cases or in other cases, giving countenance to a reorganization plan which, while writing down the interests of creditors, gives the stockholders a free ride. But it is a rather usual thing to make provision that the stockholders are to have the privilege of subscribing to junior securities of the new corporation.

The participation by stockholders in a situation such as the instant one, if permitted at all, should be conditioned upon the payment of some substantial sum and upon an underwriting of a fair amount of additional capital.

If those who are responsible for this ill-conceived merger and who are now seeking to carry out the Plan of Reorganization and the continuance of this unsuccessful business had seen fit to create a substantial fund of new money sufficient to cover several years of prospective deficits, it would constitute some justification for the plan, but as it is, they insist upon continuing the business at the sole risk of the debenture holders, while giving the stockholders a free ride.

It should be noted that under the Plan of Reorganization, the debenture holders are required virtually to make a complete surrender of their position as creditors.

Although to the extent of 50% of the present face amount of the debentures, the plan provides for new debentures, these new debentures are income debentures or virtually preferred stock.

Under the plan, the old management are in a position to continue the operation of the enterprise, their past record in the management of which has shown nothing but deficits, until the whole creditors' fund is completely wasted.

Is a dissenting creditor, who urges his legal right to present satisfaction out of the corporate assets, rather than standing aside indefinitely while the waste is completed, to be condemned as an obstructionist? And are Equity Courts autocratically to deprive him of his legal rights on pain of his acquiescence in the desires of a group of the debenture holders and stockholders to effectuate an ill-conceived reorganization?

The arrangement is most unfair to the debenture holders and other creditors and the Plan should not have been approved.

An underlying and fundamental error into which the Courts below fell, in approving the plan and making the decree of sale for the purpose of effectuating it, was the gratuitous assumption that it was a constructive and beneficial thing for the corporation to be reorganized. We submit that Courts should not proceed upon such gratuitous assumptions. Where, as here, the business of an ordinary industrial corporation is a demonstrated failure, plans for its reorganization are not constructive or of a beneficial nature either for the creditors or in a broader economic sense. We submit it is better that, when, as here, such a business is a demonstrated failure, as much as possible of the creditors' moneys should be gotten out, and that any other course violates the creditors' fundamental legal right.

The Courts below laid much stress upon the fact that ninety odd per cent. of the debenture holders had acquiesced in the plan, almost as though that were conclusive of its fairness and propriety, and indicating seemingly the view that a majority of the creditors are entitled to any assistance which they may ask from the Court to effectuate their purposes. It is well, therefore, to consider how much significance should fairly be given to this circumstance.

When publicly owned securities in a corporation such as this are defaulted, the individual security holder has little choice of action. A reorganization plan proposed by the management and sponsored by the banking house of issue is adhered to generally as a matter of pure inertia. The plan is accepted by the rank and file for the simple reason that they have no other practical recourse or remedy.

In the instant case it is true that the debenture holders were given an opportunity to rally in protection of their interests under the standard of an opposition Protective Committee, but as soon as this movement gained strength the proponents of the plan were able to arrest it by inducing the "Protective Committee" to abandon their opposition, and thus the last practical opportunity for the ordinary debenture holders to make any choice was removed. The Reorganization Committee, whose expenses, as above stated, were underwritten by the corporation, agreed to pay the opposition "Protective Committee" $35,000 for "services" etc. in return for the "Protective Committee" turning over to it nearly $1,000,000 of debentures which had been deposited with the so-called "Protective Committee" and abandoning their opposition (R. 507-8). Lip service was paid to the request of the "Protective Committee" that changes in the plan be made, but these changes were immaterial and without substance (R. 363-5, 383-6).

True it is that a single creditor may come to the seat of the Court and seek to be heard. In the instant case this petitioner attempted to do that, to be confronted by the respondent's assertion that this petitioner did not have a right to intervene (R. 98-100). True it is also that after argument occupying a whole morning's session in court, this petitioner was permitted to intervene (R. 134), with the consequences above set out.

Nor should the judgment of the sponsors of such a plan of reorganization be regarded as conclusive under the circumstances. This is so for the reason that they are prejudiced. The plan of reorganization here was sponsored by those who sponsored the merger,—that is to say, the officers of the corporation and the banking house of issue of the $12,000,000 of debentures. Human nature being what it is, their reluctance to admit error in having brought about this ill-conceived merger would induce them to sponsor this ill-conceived reorganization, even if that were not the best thing to be done in the real interests of the creditors. Liquidation, though sometimes as here the proper measure, is always an heroic one. The management is further prejudiced because while the business goes on they will continue to enjoy their salaries.

The interest of stockholders is in every sense subordinate to the rights of creditors. We submit that under our system there is and should be no judicial process,—even including a Federal equity suit for the purpose of effectuating a Plan of Reorganization,—by which the stockholders of a corporation can bring about a conversion of its indebtedness for the stockholders' benefit. That was the clear purpose of this proceeding and the decree which was sought and obtained is clearly erroneous.

The stockholders here are in the position of insolvent debtors who cannot reserve an interest as against their creditors.

B. The plan discriminated between various general creditors of the same class by providing for the payment of some of them in full in cash while only providing for others securities in the new corporation of comparatively little value.

Other than for the indebtedness to the debenture holders and the $60,000 indebtedness to the petitioner, International Heater Company, the corporation at the time of the receivership had no creditors excepting for about $46,000 then owing to miscellaneous creditors, chiefly merchandise creditors. In view of the magnitude and scope of the corporation's operations it would seem that current liabilities would normally exceed such an amount and that the management, in anticipation of the receivership, had paid down its miscellaneous current indebtedness as closely as it could arrange to do. The plan contemplates the payment of all the creditors, excepting only the debenture holders and the International Heater Company, in full in cash, and it appeared in the proceedings below that this had been done.

While, as argued below by counsel for the respondents, the adopting of this course might seem good business from the standpoint of the objectives of the reorganization committee,—in that the management thus preserved the good will of the various concerns with whom they would need to continue friendly business relations, —clearly the discrimination thus brought about is without justification. The respondents below relied upon what they stated to be the six months' rule in respect to merchandise creditors. But, as is well established, this

rule has no application excepting to receiverships of public utilities. *Spencer* v. *Taylor Creek Ditch Co.*, 194 Fed. 635 (C. C. A. 9th 1912).

POINT III

The District Court erred in parting with the trust fund and directing the delivery of it to the new corporation, there to be consumed and wasted, after the appeal from the final decree of sale had been perfected, as the Court then had become powerless further to act in the premises.

While an appeal or writ of error which has been perfected is in force, the lower Court has no further jurisdiction in the case except to take appropriate steps to perfect the record to go to the Appellate Court or to protect the *res* pending the review. For this purpose an appeal is deemed to be perfected by the allowance thereof, the filing of the assignments of error, the approval of the required bond and the signing of the citation.

Hovey v. *McDonald*, 109 U. S. 150, 3 Sup. Ct. 136, 27 L. Ed. 888 (1883);
Newton v. *Consolidated Gas Co.*, 258 U. S. 165, 42 Sup. Ct. 264, 66 L. Ed. 538 (1921);
Merrimack River Sav. Bank v. *Clay Centre*, 219 U. S. 527, 31 Sup. Ct. 295, 55 L. Ed. 320 (1910).

In view of the fact that the appeal from the final decree of sale dated May 31, 1932, had been allowed, an appeal bond fixed, filed and approved, the assignments of error filed and the citation issued, it is clear

that the Court was without further power to act pending the appeal except to take appropriate steps in relation to the preparation of the record to be submitted to the Circuit Court of Appeals and to take appropriate steps to preserve the *res*. The Court was therefore without power to confirm the sale and to relinquish its custody of the assets to the new corporation, there to be *not* preserved but wasted. The decree dated September 8, 1932, was therefore clearly erroneous,—the Court below was without power to make it.

Apparently the complainants (the Reorganization Committee) thought that by inducing the Court,—notwithstanding the pendency of the perfected appeal from the final decree of sale,— to make the further decree of September 8, 1932, and thus bring about the relinquishment of the assets by the Court and the transfer of them to the new corporation, the higher Courts would be confronted with a *fait accompli*.

This petitioner did everything it could to have the corporate assets preserved in the Court's hands during the disposition of the then pending appeal from the final decree of sale dated May 31, 1932. It asked the District Court to refrain from making the further decree dated the 8th day of September, 1932 which directed the transfer of the assets by the Receivers to the new corporation, and cited to that Court the judicial decisions appearing on the previous page. When the District Court refused to do this, it sought a suitable dispensation from the Presiding Judge of the Circuit Court of Appeals, which was refused. The order of the Presiding Judge denying the application stated that the denial was upon the ground that these petitioners refused to give any "bond of indemnity whatever" (Supp. R. 564). As it clearly appeared in the written petition or application that the requisite appeal bond upon the then pending appeal from

the decree of May 31 had been filed and approved, this order did not, of course, intend to refer to that. The Presiding Judge made it clear at the hearing upon this application that he would require the petitioners to enter into an undertaking to save the new corporation harmless from all loss. These petitioners were not asking for a stay of the decree of sale from which the appeal had then been perfected. They were asking that the Court should refrain from making further decrees in violation of the rule laid down by this Court in *Hovey* v. *McDonald*.

CONCLUSION

The decrees of the courts below should not be permitted to stand.

Since the District Court, at the behest of the complainants (the Reorganization Committee), saw fit,—notwithstanding the pending appeal from the final decree of sale dated the 31st day of May, 1932,—to make its further decree dated the 8th day of September, 1932, directing the Receivers to convey to the nominee of the Reorganization Committee, *viz.*, the new corporation organized by such Committee, all of the assets of the corporation, and since, pursuant thereto, such assets have passed out of the hands of the Court and into the hands of the new corporation where they have since been subject to change and waste, the fund as it stood in the hands of the Court has ceased to exist, so that a direction by this Court that the fund be duly administered by the District Court has become impossible of actual performance.

Under the Plan of Reorganization, a share in the assets has been unconditionally reserved in the old stockholders, although the Plan provides for a reduction

of the interest of the creditors as such in the fund. Such stockholders stand "in the position of insolvent debtors who cannot reserve an interest as against their creditors," and this doctrine is the "fixed principle * * * and to it there should be rigid adherence."

It is respectfully submitted that this Court should under the circumstances apply the remedy used by it in the case of *Shapiro* v. *Wilgus, supra,* and in the case of *Northern Pacific Railroad Company* v. *Boyd, supra,* and direct that this petitioner have a lien upon the assets of National Radiator Corporation (Maryland), the new corporation, for the amount of the principal of this petitioner's indebtedness with interest, costs and disbursements including counsel fees. The new corporation has been admitted as a party to the cause. Although this Court in its most recent decision upon the subject *(National Surety Co.* v. *Coriell, supra)* did not apply this remedy, it should be noted, that, before the decision was made by this Court, the new corporation in that case had been decreed to be a bankrupt and a sale in bankruptcy had been made of all of its assets to purchasers who were not before the Court.

Dated, New York, October 16, 1933.

Respectfully submitted,

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